PRIVATE SECURITIES LITIGATION/Safe Harbor Scienter Standard

SUBJECT: **Private Securities Litigation Reform Act of 1995 . . . S. 240. D'Amato motion to table the Sarbanes amendment No. 1478.**

ACTION: MOTION TO TABLE AGREED TO, 50-48

SYNOPSIS: As reported with an amendment in the nature of a substitute, S. 240, the Private Securities Litigation Reform Act, will enact changes to current private securities litigation practices in order to discourage unjust suits and to provide better information and protection from fraud for investors.

The Sarbanes amendment would strike the bill section that will make a forward-looking statement that was "knowingly made with the purpose and actual intent of misleading investors" exempt from safe harbor protection, and thus actionable, and would insert in lieu thereof that a forward-looking statement that was "made with the actual knowledge that it was false or misleading" exempt from safe harbor protection.

Debate was limited by unanimous consent. Following debate, Senator D'Amato moved to table the Sarbanes amendment. Generally, those favoring the motion to table opposed the amendment; those opposing the motion to table favored the amendment.

Those favoring the motion to table contended:

In comparing the proposed exclusion from the safe harbor in the substitute with the proposed exclusion in the Sarbanes amendment, some might well conclude that the differences are more of style than of substance. However, we are not niggling over how many angels can dance on the head of a pin. Though the language appears similar, the Sarbanes amendment would effectively do away with the safe harbor. Under the substitute amendment's language, companies that qualify for safe harbor protection, and that make the disclaimers for their forward-looking statements that they are speculative and thus may not come true, will still be open to suit for a statement they make that is "knowingly made with the purpose and actual intent of misleading investors." The Sarbanes amendment would change the wording to "made with the actual knowledge that it was false or misleading."

(See other side)

YEAS (50)

Republicans (46 or 88%)		Democrats (4 or 9%)
Abraham	Hatfield	Dodd
Ashcroft	Helms	Ford
Bennett	Hutchison	Lieberman
Brown	Inhofe	Reid
Burns	Jeffords	
Campbell	Kassebaum	
Chafee	Kempthorne	
Coats	Kyl	
Cochran	Lott	
Coverdell	Mack	
Craig	McConnell	
D'Amato	Nickles	
DeWine	Packwood	
Dole	Pressler	
Domenici	Santorum	
Faircloth	Simpson	
Frist	Smith	
Gorton	Snowe	
Gramm	Stevens	
Grams	Thomas	
Grassley	Thompson	
Gregg	Thurmond	
Hatch	Warner	

NAYS (48)

Republicans (6 or 12%)	Democrats (42 or 91%)	
Cohen	Akaka	Inouye
McCain	Baucus	Johnston
Murkowski	Biden	Kennedy
Roth	Bingaman	Kerrey
Shelby	Boxer	Kerry
Specter	Bradley	Kohl
	Breaux	Lautenberg
	Bryan	Leahy
	Bumpers	Levin
	Byrd	Mikulski
	Conrad	Moseley-Braun
	Daschle	Moynihan
	Dorgan	Murray
	Exon	Nunn
	Feingold	Pell
	Feinstein	Pryor
	Glenn	Robb
	Graham	Rockefeller
	Harkin	Sarbanes
	Heflin	Simon
	Hollings	Wellstone

NOT VOTING (1)

Republicans (1)	Democrats (0)
Lugar-[2]	

VOTING PRESENT(1)

Bond

EXPLANATION OF ABSENCE:

1—Official Buisiness
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:

AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

These similar sounding phrases would have very different legal effects. The best way to understand these different effects is through an example. Suppose that a company plans on introducing a major new product line. Suppose also that most of the managers in the company are convinced that the product will be ready to go on the market in September, but that a few managers have differing opinions, with one manager believing that the product will be delayed for a month because he suspects there will be problems with one of the company's suppliers. During the development of the product, the Chief Executive Officer (CEO) of that company would likely review hundreds if not thousands of memos from managers on the new product. Under current law, the CEO in this example would have a dilemma. He would want to give investors timely notice of the firm's plan to introduce the product in September, but if he did, he could be sued if the prediction did not come true. If someone invested in the company based on the belief that the product would be introduced on time, he could then allege that the company was reckless in making the prediction or that it knew it was false. If the product was delayed because the one manager's prediction of trouble with a supplier came true, then a memo on that subject by that manager could be held up as evidence that the CEO "knew" that the prediction was false. Even though other managers had made other predictions, both more optimistic and more pessimistic based on other predictions, a suit could allege that the memo by the manager who predicted correctly was proof of knowledge and thus fraud. Even if the product came on line a month later, causing a jump in stock value that more than fully recouped investor losses, the suit would already have been filed and would continue to grind on.

Under the Sarbanes amendment, the above-described suit could go forward. A lawyer, on the basis of the memo by the one manager, could allege that because the CEO had read that memo, he had actual knowledge that the statement that the product would be introduced in September was false and misleading. Under the substitute amendment, though, "actual intent" to mislead would also have to be alleged. The seemingly redundant phrase "actual intent" is a legal term of art that sets a higher standard than "implied intent." "Actual intent" requires proof of intent to deceive; under this substitute, it would not be enough to say that the fact that the CEO saw the memo implies that he had an intent to deceive because his forward-looking statement ignored that memo. This standard is similar to the libel standard. A newspaper may not be held liable for inadvertently printing inaccurate information; it can only be found guilty of libel if malice is proven. The actual intent to mislead standard is similar to the malice standard.

The Sarbanes amendment, though it sounds very reasonable, would not protect a company from unjust suits over forward-looking statements that it "knew" were untrue. It is not enough for an amendment to look good on paper; it also needs to work well in practice. In practice, the Sarbanes amendment would seriously weaken the safe harbor provision in the substitute amendment. We thus urge our colleagues to join us in tabling it.

Those opposing the motion to table contended:

We are disappointed that our colleagues rejected our amendment to leave the issue of developing safe harbor provisions to the SEC. Their rejection of that amendment has forced us to offer this amendment to correct a serious deficiency we find with their proposed safe harbor provisions. That deficiency is that it will allow companies to issue forward-looking statements that it is fully aware are false and misleading, as long as it cannot be proven that they made such false statements with the actual intent of misleading investors. We are absolutely shocked at this proposal. All but the most egregious fraudulent actions will be officially sanctioned. The Chairman of the SEC, the Government Finance Officers Association and the National Association of Securities Dealers have all strenuously objected to this proposal, which they believe will lead to massive fraud with no chance of prosecution and recovery for investors. Even forward-looking statements that companies freely admit they knew were false would be protected, as long as it could not be proven, not implied, but proven, that they were made to mislead investors. This standard is far too high. If we allow it to pass, we will all live to regret the wave of fraud on Wall Street that will result, and that will be immune from prosecution because we passed this impossibly high standard of proof. Though securities companies in America are beset by suits, the solution is not to legalize fraud. We urge our colleagues to listen to all the experts who have said that the substitute amendment's scienter standard for forward-looking statements would protect fraud, and to join us in supporting the Sarbanes amendment as a reasonable alternative.